

GAO

Testimony

Before the Subcommittee on Defense,
Committee on Appropriations, House of
Representatives

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DOD ACQUISITIONS

Contracting for Better
Outcomes

Statement of David M. Walker
Comptroller General of the United States



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Highlights of [GAO-06-800T](#), a testimony before the Subcommittee on Defense, Committee on Appropriations, House of Representatives

Why GAO Did This Study

The Department of Defense's (DOD) spending on goods and services has grown significantly since fiscal year 2000 to well over \$250 billion annually. Prudence with taxpayer funds, widening deficits, and growing long-range fiscal challenges demand that DOD maximize its return on investment, while providing warfighters with the needed capabilities at the best value for the taxpayer. DOD needs to ensure that its funds are spent wisely, and that it is buying the right things, the right way.

In this testimony, GAO discusses (1) recent trends in DOD contracting activity and the environment in which this activity takes place, and (2) practices which undermine its ability to establish sound business arrangements, particularly those involving the selection and oversight of DOD's contractors and incentivizing their performance.

This statement is based on work GAO has completed over the past 6 years covering a range of DOD acquisition and contracting issues. Some of these issues are long-standing. GAO has identified DOD contract management as a high-risk area for more than a decade. With awards to contractors large and growing, DOD will continue to be vulnerable to contracting fraud, waste or misuse of taxpayer dollars, and abuse.

www.gao.gov/cgi-bin/getrpt?GAO-06-800T

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine V. Schinasik at (202) 512-4841 or schinaski@gao.gov.

September 7, 2006

DOD ACQUISITIONS

Contracting for Better Outcomes

What GAO Found

DOD obligated nearly \$270 billion on contracts for goods and services in fiscal year 2005, an 88 percent increase over the amount obligated in fiscal year 2000. All indications are that this upward trend will continue. Aside from growth in dollar value there have also been changes in what DOD is buying. DOD's new weapons system programs are expected to be the most expensive and complex ever and will consume an increasingly large share of its budget. In the last 5 years DOD has doubled its commitment to major weapon systems from \$700 billion to \$1.4 trillion, and DOD is counting on these efforts to fundamentally transform military operations. As overall obligations have increased so has its reliance on the private sector to provide services to fulfill DOD's missions and support its operations. Additionally, in recent years DOD has increased its use of existing contracts awarded by other agencies (i.e. interagency contracts). While this approach provides a number of benefits, our work, and that of some agency inspector generals, revealed instances of improper use, including issuing orders that were outside the scope of the underlying contract as well as failing to establish clear lines of accountability and responsibility. While the amount, nature, and complexity of DOD contract activity have increased, its acquisition workforce has remained relatively unchanged in size. At the same time, the acquisition workforce faces certain skills gaps and serious succession planning challenges.

There are a number of DOD practices which undermine its ability to establish sound business arrangements. For example, with regard to competition and pricing, we recently found that the Army acquired guard services under authorized sole-source contracts at 46 of 57 Army installations, despite the Army's recognition that it was paying about 25 percent more for its sole-source contracts than for those it previously awarded competitively. Another element of a sound business arrangement is the fee mechanism used to incentivize excellent contractor performance. In December 2005, we reported that DOD gives its contractors the opportunity to collectively earn billions of dollars through monetary incentives. Unfortunately, we found DOD programs routinely engaged in practices that failed to hold contractors accountable for achieving desired outcomes and undermined efforts to motivate results-based contractor performance. As a result, DOD paid out an estimated \$8 billion in award fees on contracts in our study population, regardless of whether acquisition outcomes fell short of, met, or exceeded DOD's expectations. DOD also increased its risk of poor acquisition outcomes by not assuring that another element of a sound business arrangement, contractor oversight, was sufficient. For example, in 2005 we reported that DOD's oversight on nearly a third of 90 service contracts reviewed was insufficient, in part because DOD failed to assign performance monitors.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss challenges that the Department of Defense (DOD) faces to achieving better acquisition outcomes. With DOD spending well over \$250 billion annually to acquire products and services, prudence with taxpayer funds, widening deficits, and growing long-range fiscal challenges demand that DOD maximize its return on investment and provide the warfighter with needed capabilities at the best value for the taxpayer. DOD needs to ensure that its funds are spent wisely, and, in doing so, it needs to ensure that it is buying the right things, the right way. Several elements are essential to achieving this objective, including a sound business case supporting executable programs, sound business arrangements, and clear lines of responsibility and accountability.

My testimony today is based on work we have completed over the past 6 years that covered a range of acquisition and contracting issues and which was conducted in accordance with generally accepted government auditing standards. My testimony will focus on (1) DOD's recent contracting trends, such as the spending on goods and services and the environment in which this activity takes place; and (2) selected practices which undermine DOD's ability to establish solid business arrangements, particularly those involving the selection and oversight of DOD's contractors and incentivizing their performance. As requested, we have included briefing slides that we previously gave to your staff regarding these issues and I will make reference to specific slides during the course of my testimony.

First, I would like to reiterate the broader context. Given current policies, in the next few decades the nation will face large and growing structural deficits due to known demographic trends, rising healthcare costs and current revenue-to-expenditure gaps. At the same time, weapons programs are commanding more and more resources as DOD undertakes increasingly ambitious efforts to transform its ability to confront current and potential threats. Further, managing DOD is a challenge as it is one of the world's largest and most complex organizations, spending billions of dollars each year to sustain key business operations that support our forces. While DOD has embarked on a series of efforts to reform its business operations, serious challenges and inefficiencies remain. In fact, eight individual areas that GAO considers to be high risk because of their greater vulnerabilities to fraud, waste, abuse and mismanagement are

specific to DOD. Some of these issues are long-standing; for example, we have identified DOD weapon systems acquisition and contract management as high-risk areas for more than a decade.¹ In a report issued in July,² we concluded that, with awards to contractors large and growing, DOD will continue to be vulnerable to contracting fraud, waste or misuse of taxpayer dollars, and abuse. While DOD has acknowledged its vulnerabilities and taken some actions to address them, many of the initiatives are still in their early stages and it is too soon to tell what impact they may have.

Further, there are numerous factors that can contribute to poor acquisition outcomes, which in turn erode DOD's buying power. We list some of these factors on slide 2. This list is illustrative and not intended to be exhaustive, and the risk these factors pose may manifest itself differently depending on the nature of the acquisition. To start, DOD's tendency to look for revolutionary solutions that depend on the maturation and availability of critical technologies often results in programs taking longer, costing more and delivering less capability than originally promised to the warfighter. Further, DOD wants often do not reflect "true" requirements—in other words, based on credible threats and risk-based needs—resulting in a mismatch between wants, needs, affordability and sustainability. Once true requirements are established, they need to be stable. At times, DOD has allowed new requirements to be added well into the acquisition cycle, significantly stretching technology and creating design challenges, and exacerbating program budget overruns. Of course, defining requirements, managing contracts and overseeing contractors requires a capable workforce that is up to meeting these challenges, adheres to sound contracting practices, and provides contractors with incentives that are based on results, rather than attitudes and efforts.

Recent Contracting Trends

With this context in mind, I would like to turn now to recent trends in DOD's contracting activities. If you would turn to slide 4, DOD's spending on goods and services has increased by 88 percent since fiscal year 2000. In fiscal year 2005, DOD obligated nearly \$270 billion on contracts for

¹ GAO, *GAO's High-Risk Program*, [GAO-06-497T](#) (Washington, D.C.: Mar. 15, 2006); and GAO, *High-Risk Series: An Update*, [GAO-05-207](#) (Washington, D.C.: Jan. 2005).

² GAO, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*, [GAO-06-838R](#) (Washington, D.C.: July 7, 2006).

products, research and development efforts, and services, such as for information technology and management support.

All indications are that this upward trend will continue. Aside from growth in dollar value, there have also been changes in what DOD is buying. DOD's new weapon system programs are expected to be the most expensive and complex ever, and will consume an increasingly large share of DOD's budget. To illustrate, in the last 5 years DOD has doubled its commitment to major weapon systems from \$700 billion to \$1.4 trillion. DOD is counting on these efforts to fundamentally transform military operations. The Army, for example, is undertaking the Future Combat Systems program—a family of weapons, including 18 manned and unmanned ground vehicles, air vehicles, sensors and munitions, that will be linked by an information network—to enable its combat force to become lighter, more agile, and more capable. Future Combat Systems' procurement will represent 60 to 70 percent of Army procurement from fiscal years 2014 to 2022.

The Army, however, is not alone in pursuing complex and costly systems. For example, the Air Force is modernizing its tactical aircraft fleet as part of the \$200 billion Joint Strike Fighter program and the F-22A Raptor aircraft, which is expected to cost more than \$65 billion. Similarly, the Navy's Virginia class submarine is expected to cost about \$80 billion, while the DDG-51 class of destroyer is expected to cost some \$70 billion. DOD's development of such systems requires more funds than may reasonably be expected to be available. For example, we testified in April 2006 that the Navy's shipbuilding plan projects a supply of shipbuilding funds that will double by 2011 and will stay at high levels for years to follow.³

As overall obligations have increased, so has DOD's reliance on the private sector to provide services to fulfill DOD's missions and support its operations. In some cases, the growth in services reflects that DOD is using a different acquisition approach to support its missions. For example, DOD is now buying launch services, rather than rockets. Service contracts pose a number of challenges in terms of defining requirements, establishing expected outcomes, and assessing contractor performance.

³ GAO, *Defense Acquisitions: Actions Needed to Get Better Results on Weapons Systems Investments*, GAO-06-585T (Washington, D.C.: April 5, 2006).

Additionally, in recent years, federal agencies including DOD have moved away from using in-house contracting capabilities and are making greater use of existing contracts awarded by other agencies. If you would turn now to slide 7, these interagency contracts are intended to

- leverage the government's buying power;
- provide a faster and easier method for procuring commonly used goods and services, and
- reduce initial contracting administrative costs.

DOD is the largest user of these interagency contracting vehicles, and their availability has enabled DOD to save time by paying other agencies to award and administer contracts for goods and services on its behalf. DOD, however, lacks complete information about purchases made through other agencies' contracts. Moreover, our work and that of some agency inspectors general have uncovered instances of improper use of interagency contracts, including issuing orders that were outside the scope of the underlying contract, failing to follow procedures intended to ensure best pricing, and failing to establish clear lines of accountability and responsibility. Further, in some instances fee-for-service arrangements may have led to an inordinate focus on meeting customer demands at the expense of complying with sound contracting policy and required ordering procedures. These and other issues led us to designate management of interagency contracting a governmentwide high-risk issue in January 2005. Ensuring the proper use of interagency contracts must be viewed as a shared responsibility which requires that agencies clearly define responsibilities and adopt clear, consistent, and enforceable policies and processes that balance the need for customer service with the requirements of contract regulations.

At the same time that the amount, nature, and complexity of contract activity has increased, DOD's acquisition workforce has remained relatively unchanged in size and faces certain skill gaps and serious succession planning challenges. DOD's acquisition workforce must have the right skills and capabilities if it is to effectively implement best practices and properly manage the goods and services it buys. We noted in a report issued in 2003, and again in July 2006, however, that procurement reforms, changes in staffing levels, workload, and the need for new skill

sets have placed unprecedented demands on the acquisition workforce.⁴ Moreover, DOD's current civilian acquisition workforce level reflects the considerable downsizing that occurred in the 1990s. DOD's approach to acquisition workforce reduction during the 1990s was not oriented toward shaping the makeup of the workforce; rather, DOD relied primarily on voluntary turnover and retirements, freezes on hiring authority, and its authority to offer early retirements and buyouts to achieve reductions. Indeed, during our work on the early phases of DOD downsizing, some DOD officials voiced concerns about what was perceived to be a lack of attention to identifying and maintaining a balanced, basic level of skills needed to maintain in-house capabilities.

Sound Business Arrangements

I would like to turn now to briefly discuss some of DOD's practices in three areas—(1) competition and sound pricing; (2) incentivizing contractors; and (3) contract oversight—that increase risks and undermine DOD's ability to establish sound business arrangements.

Competition and Sound Pricing

Our work has identified a number of issues related to competition and pricing in DOD's efforts to obtain needed goods and services. Under the Competition in Contracting Act of 1984, DOD contracting officers are, with certain exceptions, to solicit offers and award contracts using full and open competition, in which all responsible sources are permitted to compete. As shown on slide 10, DOD reports that only forty-one percent of its contract obligations in fiscal year 2005 were made on contracts that were awarded using full and open competition. The impact of not using full and open competition is reflected in one recent example involving the Army's award of sole-source contracts for security guards. In this case, we found that the Army devoted twice as many contract dollars—nearly \$495 million—to sole-sourced contracts for security guards at 46 of 57 Army installations, despite the Army's recognition that it was paying about 25 percent more for its sole-source contracts than for those it previously awarded competitively.⁵

⁴ GAO, *Federal Procurement: Spending and Workforce Trends*, GAO-03-443 (Washington, D.C.: April 30, 2003); and GAO, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*, GAO-06-838R (Washington, D.C.: July 7, 2006).

⁵ GAO, *Defense Acquisitions: DOD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes*, GAO-06-66 (Washington, D.C.: Dec. 19, 2005); and GAO, *Defense Acquisitions: DOD Wastes Billions of Dollars through Poorly Structured Incentives*, GAO-06-409T (Washington, D.C.: April 5, 2006).

Incentivizing Contractors

Another element of a sound business arrangement is the fee mechanism used to incentivize excellent contractor performance. In December 2005, we reported that DOD gives its contractors the opportunity to collectively earn billions of dollars through monetary incentives.⁶ Unfortunately, we found DOD programs routinely engaged in practices that failed to hold contractors accountable for achieving desired outcomes and undermined efforts to motivate results-based contractor performance, such as

- evaluating contractor performance on award-fee criteria that are not directly related to key acquisition outcomes (e.g., meeting cost and schedule goals and delivering desired capabilities to the warfighter);
- paying contractors a significant portion of the available fee for what award-fee plans describe as “acceptable, average, expected, good, or satisfactory” performance, which sometimes did not require meeting the basic requirements of the contract; and
- giving contractors at least a second opportunity to earn initially unearned or deferred fees.

As a result, DOD has paid out an estimated \$8 billion in award fees on contracts in our study population, regardless of whether acquisition outcomes fell short of, met, or exceeded DOD’s expectations. On slide 15, we have included four cases in which contractors that were behind schedule and over cost were paid between 74 and 100 percent of the available award fee.

Despite paying billions of dollars in award and incentive fees, DOD has not compiled data or developed performance measures to evaluate the validity of its belief that award and incentive fees improve contractor performance and acquisition outcomes. DOD’s strategies for incentivizing its contractors, especially on weapon system development programs, are symptomatic of a lack of discipline, oversight, transparency, and accountability in DOD’s acquisition process.

Contract Oversight

I would like to briefly discuss the third element of sound business arrangements, DOD’s oversight of its service contracts. Government monitoring and inspection of contractor activity, if not done well, can contribute to a lack of accountability and poor acquisition outcomes. In 2005, we reported that DOD’s monitoring of nearly a third of the 90 service

contracts we reviewed was insufficient.⁷ In these cases, we identified a number of contributing factors, including DOD's failure to assign government performance monitors and the fact that personnel are usually assigned such duties on a part-time basis and not evaluated on how well they performed their duties. DOD and senior military acquisition policy officials acknowledged that the priority of contracting offices is awarding contracts, not ensuring that trained performance monitors are assigned early so that contract oversight can begin upon contract award. Ultimately, however, if appropriate monitoring is not being done, DOD is at risk for paying contractors more than the value of the services they performed.

In closing, these three illustrative business arrangement issues, along with those we have identified in DOD's acquisition and business management processes, present a compelling case for change. In short, it takes a myriad of things to go right for acquisitions to be successful, but only a few things to go wrong to cause major problems. Slide 17 provides examples of the impact that these problems can have on reducing the government's buying power. Such examples illustrate the outcomes of poor acquisition executions. The debate now centers on future investments and what return on investment will be realized.

Finally, on slide 18 you will find a number of actions that can and should be taken to improve acquisition outcomes. By implementing the recommendations we have made on individual issues, DOD can improve specific processes and activities and save huge amounts of taxpayer dollars. At the same time, by working more broadly to improve its acquisition practices, DOD can set the right conditions for becoming a smarter buyer, getting better acquisition outcomes, and making more efficient use of its resources in what is sure to be a more fiscally constrained environment. DOD's written acquisition policies reflect many of our recommendations and often incorporate best practices. As such, the policies provide the basis for sound decisions and actions. The policies, however, are not consistently manifested on decisions made on individual acquisitions. In these cases, officials are rarely held accountable when acquisitions go astray. It is essential to create an environment conducive to changing behaviors and to recognize that achieving sound acquisition outcomes are a shared responsibility between the Congress, DOD, and the contractor community. Unless changes are made, DOD will

⁷ GAO, *Contract Management: Opportunities to Improve Surveillance on Department of Defense Service Contracts*, GAO-05-274 (Washington, D.C.: Mar. 17, 2005).

continue on a path where wants, needs, affordability and sustainability are mismatched, with predictably and recurring unsatisfactory results.

Mr. Chairman and members of the subcommittee, this concludes my testimony. I would be happy to answer any questions you may have.

Scope and Methodology

In preparing for this testimony, we relied principally on previously issued GAO reports. We also obtained data on DOD's contract activity from DOD's DD350 database and from the General Services Administration's Federal Procurement Data System. We have previously expressed concerns about the accuracy of the data contained in the Federal Procurement Data System. We determined, however, that the data were sufficiently reliable for the purposes of this testimony. We also obtained data from the Office of Personnel Management regarding DOD's acquisition workforce. For the purposes of this report, we selected 14 occupation series including contracting, business, purchasing, quality assurance and supply and inventory management personnel. We conducted our work in April and July 2006 in accordance with generally accepted government auditing standards.

Contact and Staff Acknowledgments

For further information regarding this testimony, please contact Katherine V. Schinasi at (202) 512-4841 or schinasi@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. Key contributors to this report were Lily Chin, David E. Cooper, Brendan Culley, Thomas Denomme, Timothy DiNapoli, Paul Francis, Alan Frazier, Christopher Kunitz, Michele Mackin, William Russell, Adam Vodraska, and Karen Zuckerstein.

Appendix I



DOD Acquisitions: Contracting for Better Outcomes

**House Appropriations Committee
Subcommittee on Defense
September 2006**



Factors Contributing to Poor Acquisition Outcomes

DOD's buying power eroded due to:

- Historical preference for grand, revolutionary solutions that depend on immature technology
- Frequent mismatch between wants, needs, affordability, and sustainability
- Unrealistic and continually changing requirements
- Undisciplined management of programs once started
- Lack of competition and adherence to sound contracting practices that adequately allocates risk between the contractor and taxpayer
- Incentives and fees based on attitudes and efforts rather than results
- Workforce capabilities strained to meet 21st century challenges

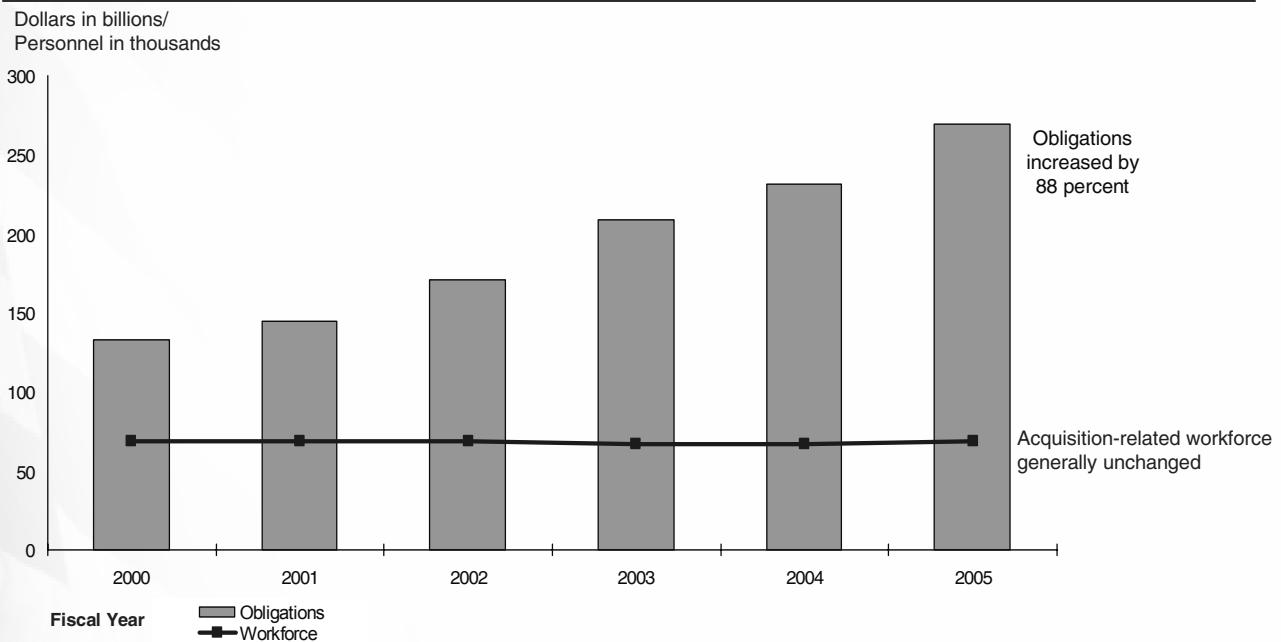


Conducting the Business of Government

- Among the 21st century challenges faced by the government is determining who will do the business of government.
- The work of the government is increasingly performed by the private sector under contract.
- DOD's spending on goods and services has grown significantly since fiscal year 2000, and all indications are the trend will continue.
- DOD's weapon systems acquisition and contract management processes have been on GAO's high-risk list for more than a decade.
- GAO designated the management of interagency contracting a governmentwide high-risk issue in January 2005; DOD is the largest user of interagency contracting vehicles.



DOD Contract Obligations and Acquisition Workforce Trends Since Fiscal Year 2000

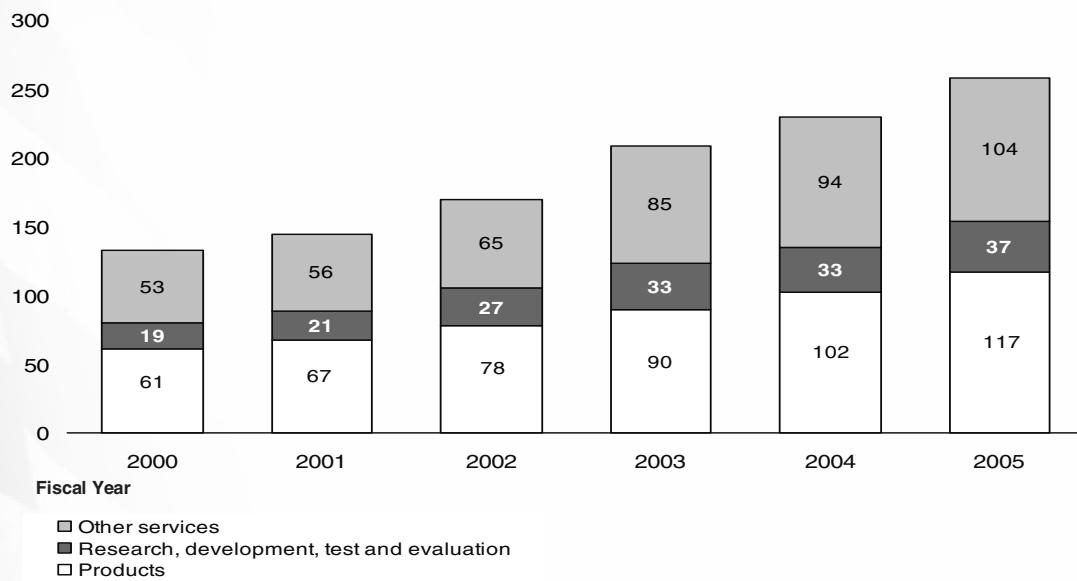


Source: Contract obligations: DD350 database.
Workforce: GAO analysis of OPM data of 14 acquisition-related job series.



Obligations Increased Across Goods and Services Categories

Contract obligations
Dollars in billions



Source: DD350 database, actions over \$25,000.



Growth in Contracting for Services Poses New Challenges

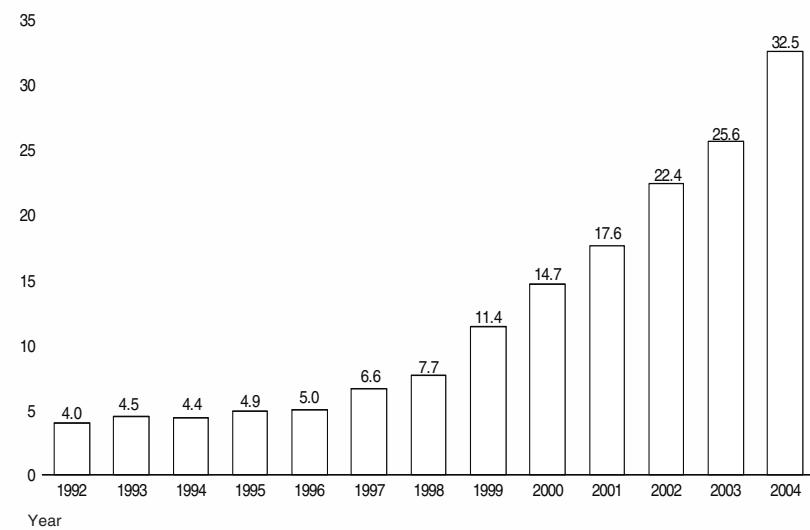
- New missions and approaches contribute to increased spending on services:
 - Following the terrorist attacks of September 11, 2001, increased security requirements and deployment of active duty and reserve personnel resulted in DOD having fewer military personnel to protect domestic installations. The U.S. Army awarded contracts worth nearly \$733 million to acquire contract guards at 57 installations.
 - The Air Force historically bought space launch vehicles, such as the Delta and Titan rockets, as products; under the Evolved Expendable Launch Vehicle program, the Air Force purchases launch services using contractor-owned launch vehicles. Projected program cost is \$28 billion.
 - Defining requirements, establishing expected outcomes, and assessing contractor performance is often more complicated compared with contracting for supplies and equipment.



Rapid Growth of Interagency Contracting

- While total sales of GSA's Multiple Award Schedule are available, data on the full extent of interagency contracting were not available.

Multiple Award Schedule Sales, Fiscal Year 1992 through 2004
Dollars in billions



Source: GSA



Interagency Contracting Designated a Governmentwide High-Risk Area

- Rapid growth in use of these contracts in terms of amount spent
- Lack of transparency and reliable data regarding extent and details of use of interagency contracting
- Increasing demands on the acquisition workforce, coupled with insufficient training and guidance
- Fee-for-service arrangements in interagency contracting, which may have led to an inordinate focus on meeting customer demands at the expense of proper use and good value
- Lack of a meaningful “fair opportunity” process when selecting contractors for individual task orders
- Lack of clearly established lines of accountability between agencies that award umbrella contracts and agencies that issue individual orders under those umbrella contracts



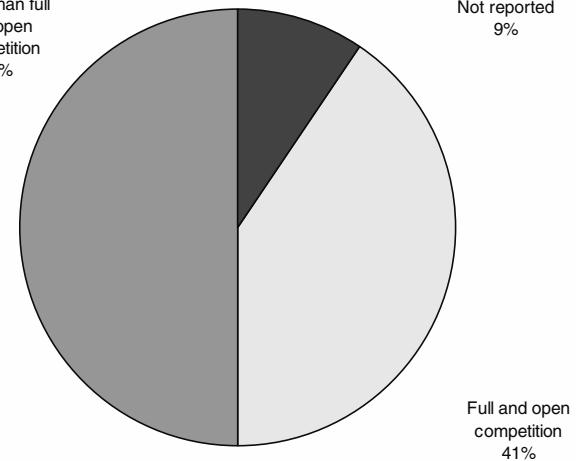
Lack of Fully Defined Requirements Increases DOD Cost Risk

- Lack of fully defined requirements in DOD acquisitions contributes to numerous changes to the scope and cost of the work.
- Use of task order contracts and time-and-materials contracts provides DOD flexibility to add work to contracts once needs are defined but may pose additional management and oversight risks.
- DOD may authorize contractors to begin work before reaching agreement on terms and conditions, including scope of work, specifications, and price, under agreements termed letter contracts or undefinitized contract actions.
 - DOD obligated nearly \$6.5 billion under letter contracts in fiscal year 2004.
 - Allows DOD to initiate work quickly to meet urgent operational needs, but contract incentives to control costs are likely to be less effective.

Competition

- The Competition in Contracting Act of 1984 requires that contracting officers promote and provide for full and open competition—i.e. all responsible sources are permitted to compete—when soliciting offers and awarding government contracts.
 - This enables the government to rely on competitive market forces to obtain needed goods and services at fair and reasonable prices.
 - Use of other than full and open competition must be justified in writing and must cite specific statutory authority.

Fiscal Year 2005 DOD Competition Statistics



Source: GAO analysis of DOD data.



Examples of Competition and Pricing Issues

- Army's approach to acquire contract guard services under sole-source contracts at 46 of 57 installations resulted in the Army paying 25 percent more for its sole-source contracts than for those it previously awarded competitively.
- February 2005 review of sole-source AWACS spare parts found that DOD did not
 - obtain or evaluate appropriate pricing information, such as sales data for items asserted to be commercial, or
 - adequately consider analyses conducted by the Defense Contract Audit Agency or Defense Contract Management Agency.
- In the absence of adequate price competition, the Truth-in-Negotiations Act enables DOD to obtain certified cost and pricing data for negotiated contracts exceeding \$550,000 that are not for commercial items.
 - GAO reviewed 20 contract actions valued at \$4.4 billion in which DOD waived the requirement for cost and pricing data.
 - DOD lacked guidance to help contracting officers determine whether a waiver should be granted, what constitutes acceptable data and analyses, or the need for assistance.



Impact of Multiple Contractor Levels on Costs Uncertain

- Evidence suggests DOD is increasingly relying on contractors to manage a greater range of responsibilities than traditional prime contractors. Examples include:
 - The Army's \$200 billion Future Combat Systems, in which the contractor is acting as a lead system integrator. Contractor is assuming greater responsibility for requirements development, design, and source selection of major system and subsystem contractors, and trade-off decisions.
 - In an interagency contract for construction services, DOD paid 7 percent to Treasury to award a contract to a staffing company, which then subcontracted to a construction firm. In combination, Army paid 17 percent more than subcontractor's proposed price.
 - Historically, DOD has limited visibility over the cost impact associated with using multiple layers of contractors to perform work.



Award- and Incentive-Fee Structures

- To encourage innovative, efficient, and effective performance, DOD provides its contractors the opportunity to collectively earn billions of dollars through monetary incentives known as award and incentive fees.
- On award-fee contracts, DOD personnel conduct periodic evaluations of the contractor's performance against specified criteria and recommend the amount of fee to be paid. Criteria and evaluations tend to be subjective.
- Incentive-fee contracts typically apply a formula, specified in the contract, that adjusts the fee based on an objective evaluation of the contractor's performance.
- DOD reports it obligated more than \$75 billion on award- and incentive-fee contracts in fiscal year 2004.



DOD Practices Undermine Award- and Incentive-Fee Objectives

- December 2005 analysis of 93 award- or incentive-fee contracts found that DOD programs engaged in practices that undermined efforts to motivate contractor performance and that did not hold contractors accountable for achieving desired outcomes. DOD
 - frequently paid most of available award fees regardless of whether acquisition outcomes fell far short of, met, or exceeded expectations;
 - allowed contractors at least a second opportunity to earn initially unearned or deferred fees; and
 - paid significant amount of fee for “acceptable, average, expected, good, or satisfactory” performance.
- Contracts with incentive fees provided a clearer link to acquisition outcomes; however, about half of the contracts failed or are projected to fail to complete the acquisition at or below the target price.
- Despite paying billions in fees, DOD has little evidence to support its contention that these fees improved contractor performance.



Award Fee Decisions Not Tied to Acquisition Outcomes

Program Performance and Award-Fee Payments on Selected DOD Development Programs

Acquisition outcomes	Comanche reconnaissance attack helicopter	F-22A Raptor tactical fighter aircraft	Joint Strike Fighter tactical fighter aircraft	Space-Based Infrared System High
Research and development cost increase over baseline	\$3.7 billion 41.2 percent	\$10.2 billion 47.3 percent	\$10.1 billion 30.1 percent	\$3.7 billion 99.5 percent
Acquisition cycle time increase over baseline	33 months 14.8 percent	27 months 13.3 percent	11 months 5.9 percent	More than 12 months
Percentage and total award fee paid to prime systems contractor (adjusted for rollover)*	85 percent \$202.5 million paid through 2004	91 percent \$848.7 million	100 percent \$494.0 million	74 percent \$160.4 million

Sources: DOD submissions to GAO, and GAO-05-301 (data); GAO (analysis).

*When calculating the percentage of award fee paid (i.e. percentage of award paid = total fee paid to date/ (total fee pool – remaining fee pool)), we included rolled-over fees in the remaining fee pool when those fees were still available to be earned in future evaluation periods.



Insufficient Oversight on DOD Service Contracts

- Monitoring and inspection of contractor performance is a key oversight mechanism.
 - If monitoring and inspection is not performed, not sufficient, or not well documented, DOD is at risk of
 - being unable to identify and correct poor contractor performance in a timely manner, and
 - paying contractors more than the value of the services performed.
- DOD personnel performed insufficient monitoring on nearly a third of the 90 service contracts reviewed in March 2005 report.
 - DOD personnel failed to assign personnel to perform monitoring or did not document monitoring and some monitoring personnel were not formally trained;
 - Monitoring is not perceived as important as awarding contracts; and
 - Personnel are usually assigned monitoring duties as a part-time responsibility and are not evaluated on how well duties were performed.



Examples of Programs With Reduced Buying Power

Billions of fiscal year 2006 dollars

Program		Initial estimate →	Initial quantity	Latest estimate →	Latest quantity	Percent of unit cost increase
Joint Strike Fighter		\$189.8	2,866 aircraft	\$216.2	2,458 aircraft	32.8
Future Combat Systems		\$82.6	15 systems	\$127.2	15 systems	54.1
F-22A Raptor		\$81.1	648 aircraft	\$66.8	185 aircraft	188.3
Evolved Expendable Launch Vehicle		\$15.4	181 vehicles	\$27.6	138 vehicles	134.7
Space Based Infrared System High		\$4.1	5 satellites	\$10.1	3 satellites	311.8
Expeditionary Fighting Vehicle		\$8.1	1,025 vehicles	\$10.9	1,025 vehicles	33.7

Source: GAO analysis of DOD Selected Acquisition Report data. Images sourced in their respective order: JSF Program Office; Program Manager, Unit of Action, U.S. Army; F-22A System Program Office; (Left) © 2003 ILS/Lockheed Martin, (right) © 2003 The Boeing Company; Lockheed Martin Space Systems Company; General Dynamics Land Systems.



Improving Acquisition Outcomes

- Reconcile the differences between wants, needs, affordability and sustainability on an enterprise-wide basis, considering current and future threats and resources levels
- Nail down system requirements and ensure the maturity of technology to improve performance and enhance accountability
- Ensure that acquisitions are performance- and outcome-based, with appropriate risk-sharing contracts in place
- Limit pay for performance-based contract incentives to positive acquisition outcomes
- Make it acceptable to pull the plug or reduce quantities of weapon systems and information systems projects when facts and circumstances warrant
- Ensure a capable acquisition workforce and accountable leadership
- Create an environment conducive to behavioral change; sound acquisition outcomes are a shared responsibility between Congress, DOD, and the contractor community
- Assure that individual decisions are consistent with sound acquisition policies and practices

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